

Taxation of Electronic Commerce

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Abstract

No other innovation, or way of doing business, has revolutionized the international economy faster than the Internet. It took generations for the Industrial Revolution to play out around the world while the Internet Revolution has unfolded in less than a decade. The speed of this change has been astounding. In the Industrial Age, as change took place, governments were able to react accordingly. In the Internet Age, today's innovation is tomorrow's standard. Government are finding that they must act on Internet time, which is a daunting challenge.

This paper examines the current state of affairs with regards to the taxation of Internet commerce. It analysis the historical perspective of the United States of America, the OECD, the WTO, and the European Union; and attempts to answer the question "What happens next?" Is there an opportunity here for developing countries to increase their tax base?

1. Introduction

The biggest standards battle in the history of the digital revolution has again heated up and the fight is about taxes – taxes on e-commerce. The unprecedented growth in the Internet during the "internet bubble economy" highlighted the glaring problems with current taxation laws that address the remote purchases of goods and services. While these problems and concerns may have been sidelined during the past couple of years with the "busting of the internet bubble", the worsening of the worldwide economic slowdown and the surfacing of the global war on terror; they have not been adequately addressed.

And, Internet commerce is not dead. Recent statistics released from the US Census Bureau of the Department of Commerce (20) shows that Internet commerce has risen during the last quarter of 2001 and the first quarter of 2002 in comparison to the last quarter of 2000 and the first quarter of 2001. There estimate of U.S. retail e-commerce sales for the first quarter of 2002, not adjusted for seasonal, holiday, and trading-day differences, was \$9.849 billion, an increase of 19.3% from the first quarter of 2001 Fig.1

Total retail sales for the first quarter of 2002 were estimated at \$743.8 billion, and increase of only 2.7% from the same period a year ago. E-commerce sales in the first quarter of 2002 accounted for 1.3 % of the total sales while in the first quarter of 2001 e-commerce sales were 1.1% percent of total sales.

The United Kingdom statistics also show a startling increase in e-commerce sales (3). The Interactive Media

(2) Retail Group (an industry body for global retailing) is now collecting hard data on online sales to UK consumers. Their IMRG Index provides robust evidence that the UK e-retail market is significantly larger and growing faster than previously estimated. The Index rose to 262 in April 2001, up from 100 in April 2000 – giving an estimate of e-commerce retail sales for the month of April 2001 of 210 million pounds sterling (16).

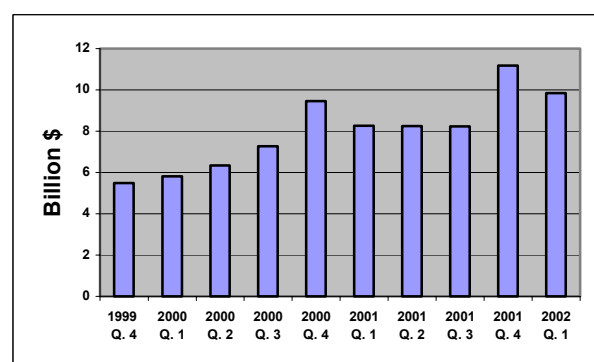


Figure 1: U.S. e-commerce retail sales

This increase of 162% in e-commerce retail sales compares with only a 5.9% increase in general retail sales. Figures from the Index similarly show an increase of 10.4% in March, 2002 compared with February, 2002 and the organization estimates that e-retail will continue to grow ten-times faster than mainstream retail, with no indication that any sector is beginning to plateau.

In a press release dated June 2002 (13), they stated "Half a billion people are online at home worldwide and a third of them shop online." They continued, "Europe now has more internet users than the US. The UK is responsible for a third of all e-retail sales in Europe, with online sales worth an estimated £507 million in May (2002) alone. Internet sales continue to surge, against the general retail trend, but while these direct sales are the most concrete manifestation of e-retail, and may reach 15% of all retail within a few years, they are only one element in the e-commerce equation."

They also highlighted that "throughout the first half of 2002 a steady stream of positive reports have been issued by e-retailers, whose ventures are showing profits - many for the first time - and experiencing rapid growth in sales. The UK e-retail market is currently growing at over 90% year-on-year, and is expected to be worth £7 billion this year (2002), representing almost 4% of the total retail market by the end of the year".

IDC Research confirms these figures (11). As the world's leading provider of technology intelligence, industry analysis, market data, and strategic and tactical

guidance to builders, providers, and users of information technology; their recent research suggests that more than 600 million people worldwide will have access to the Internet - spending more than \$1 trillion online. While the United States now accounts for 40 percent of the money spent online, they suggest that as residents of Asia and Western Europe increase their spending, The U.S. should only account for 38 percent by 2006. In some Asian nations, governments are lobbying to bring more citizens online, thus contributing to rapid Internet penetration in those markets. In Western Europe, e-commerce is expected to rise 68 percent this year as the adoption of the Euro brings better competition, price transparency, and improved deals for online buyers.

Accordingly, governments at all levels and all types of retailers are now addressing the best way to deal with legislative shortcomings surrounding the taxation of e-commerce; with local government groups pushing for tax assessment based on where the purchaser lives rather than the seller's location, and businesses lobbying for a neutral, fair and equitable, easily administered system. The EU recently acted unilaterally with their Electronic Commerce Directive.

2. The Problem

It is unquestionable that developments in e-commerce and new business models have allowed all kinds of businesses to change their trading practices in ways that were unimaginable when tax rules were developed for traditional business models. The emergence of the commercial Internet has opened new routes for the exchange of goods and services. Almost any goods that can be digitized can be bought, sold and distributed quickly and inexpensively through the Internet to consumers worldwide. Substantial questions remain, however, about how electronic commerce will be treated by the various laws of taxation.

Electronic commerce raises domestic and international tax issues. Specifically:

1. There are unique problems in tax administration posed by electronic commerce.
2. There are sales and use tax issues, such as nexus and the non-uniform (and sometimes inconsistent) manner in which tax laws treat electronic commerce-related activities.
3. There are international taxation issues arising under domestic taxation laws and foreign value added tax systems (with this changing business climate, tax authorities the world over have been particularly concerned that private customers would buy digital products and services from non domestic suppliers because no sales tax was due on these products).

Most nations have in place a system of tax laws and regulations which govern the tax treatment of goods and services crossing their borders and assert taxing jurisdiction on the basis of the "source" of income and the residence of the entity earning the income. For example, determining the source of income is important both to businesses in the United States and to foreign entities

doing business in the United States. Under the Internal Revenue Code (I.R.C.) (21), United States citizens and residents ordinarily are fully taxable in the United States on income which is derived from sources outside the United States, subject to certain exemptions and limitations. A corporation created or organized in the United States also is taxable on its worldwide income. Foreign entities, however, are generally only taxed in the United States on income generated from sources within the United States. For example, nonresident aliens in the United States and certain foreign corporations in the United States are taxed on income which is "effectively connected" to the conduct of a trade or business within the United States.

Taxation of international commerce also depends on the provisions of various international bilateral tax treaties. Among the most important concepts in these treaties is that of "permanent establishment," which is essentially a fixed place of business through which the business of an enterprise is wholly or partly carried on. To prevent double taxation of international activity, countries generally tend to restrict their taxation of business profits to those profits that are attributable to a permanent establishment in their jurisdiction.

The Internet raises difficult unresolved questions about how to determine whether an entity engaged in electronic commerce is engaged in a trade or business in a particular country or has a permanent establishment in that country for tax purposes. Parties engaged in electronic commerce, for example, may not have, or need, a physical place of business in a country in order to conduct extensive business online in that country. Thus, it is not always clear whether they have a permanent establishment which would give rise to any tax obligation. It is unlikely, however, that foreign electronic vendors who merely solicit orders within a country and then ship tangible goods into that country based on those orders will be considered as engaging in a trade or business in that country.

2.1 Where's the Nexus?

The power of a state to impose income taxes or sales or use taxes, or an obligation to collect taxes, depends on whether a "nexus" exists which would support a state's taxing jurisdiction. "Nexus" essentially means a "contact or link" - a contact or link which forms the legal basis for the imposition of taxes. Only those parties having sufficient contacts or links with a state are subject to taxes by that state - some minimum connection or link between the taxing state and the person, property, or transaction it seeks to tax. Where is the "nexus" in electronic commerce: is it between the seller and his home state, the seller and the state of the customer, the customer and the state of the seller, the customer and his/her state of residence, the internet service provider and their resident state, the internet service provider and the home state of the customer, or the internet service provider and the state of the seller? These questions still have to be answered.

In addition, if nexus exists for online transactions, the question of what, actually, is subject to sales and/or use tax remains. In general, this depends on how the transaction in question is classified under sales and use tax laws. Normally, governments distinguish between transactions in tangible personal property, services and intangibles and take a variety of approaches to classifying electronic activities under sales and use tax statutes, with little uniformity or guidance in their application. Sales and use taxes are normally imposed on retail sales of tangible personal property unless the law provides for a specific exemption or exclusion. "Tangible personal property" typically includes material goods that may be perceived by the senses. Services are not generally covered by sales and use tax unless the law specifically enumerates the services as taxed. Although services are less extensively taxed than tangible goods, over the years there has been a gradual broadening of the tax base for services. Intangibles, such as transfers of stocks and bonds or intellectual property rights, generally are not subject to sales tax. Sales and use taxation of intangible intellectual property rights has been an important issue in taxation and, given the important role that licensing plays in electronic commerce, promises to continue to be important in the future.

Taxation in connection with electronic commerce must also take into account the unique features of the Internet and other electronic networks. Most tax laws and regulations were established before the rise of electronic commerce, and are rooted in concepts of physical location or presence. Determining the identities of the parties who participate in a transaction, where a transaction is "sited," and identifying key "taxing points," for instance, are often important to the administration of taxes. These concepts, however, may be difficult to analogize to transactions occurring in cyberspace.

2.2 The Problem of Lost Revenue!

Not requiring internet-based merchants to collect sales and use taxes, places them at a significant advantage over traditional retailers. This inequity could have a profound negative impact on not only retailers but local communities because it risks governments' ability to collect the revenue needed for education, police, and other essential services, and could lead to increases in property or income taxes. In the United States nearly 40 percent of all state revenues come from the sales tax; it is the single most critical source of funding for public education. There is serious concern in the United States that unless the Congress moves to restore a level playing field by taxing internet commerce, current industry and academic studies project American States will lose between \$10-20 billion in sales tax revenues by 2003, \$45.2 in 2006 and as much as \$54.8 billion by 2011 – Figure 2 (5).

Given the above, it obvious why a central theme in the debate over the tax treatment of internet commerce centers around the extent to which the inability to tax them has eroded government sales tax collections.

Revenue losses from e-commerce generally arise because e-commerce enables a significant increase in remote sales, thereby causing a shift from collecting sales taxes at the point of sale to collecting use taxes for goods used, consumed, or stored in a jurisdiction. The resulting revenue losses are generally the result of tax evasion, not tax avoidance, since the use tax is due even if the sales tax cannot be collected.

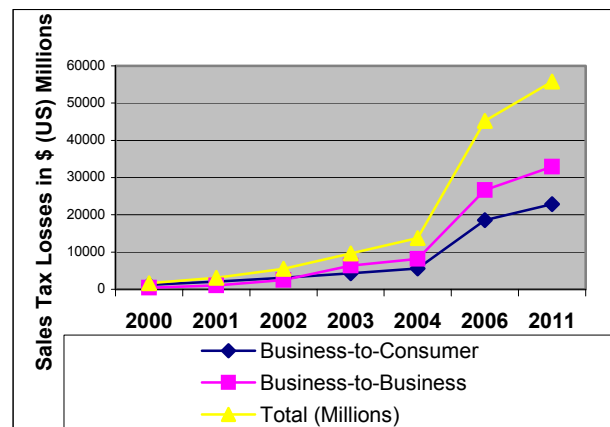


Figure 2: U.S. sales tax losses on electronic commerce

3. Are We Close to a Solution?

3.1 The Clinton Proposal:

In July 1997, the US discussion on e-commerce taxation was formalized in the Clinton Administration report entitled "A Framework for Global Electronic Commerce"(6). It articulated the United States government's view that governments should adopt a "non-regulatory, market-oriented approach to policy development around electronic commerce". The paper set forth five principles for facilitating the growth of commerce on the Internet:

1. The private sector should lead.
2. Governments should avoid undue restrictions on electronic commerce.
3. Where governmental involvement is needed, its aim should be to support and enforce a predictable, minimalist, consistent and simple legal environment for commerce.
4. Governments should recognize the unique qualities of the Internet,
5. And, electronic commerce over the Internet should be facilitated on an International basis.

It expressed the government's view that the Internet should be a tariff-free environment, and committed that the United States would advocate The World Trade Organization and other international groups to declare the Internet to be tariff-free "whenever it is used to deliver products or services". The Paper also stressed the US governments position that no new taxes should be imposed on electronic commerce and that taxation of such commerce should be consistent with established principles of international taxation. Further stating that

taxation of Internet sales should neither distort nor hinder commerce, be simple and transparent, and be able to accommodate tax systems used by the United States and its international trading partners.

3.2 The Internet Tax Freedom Act of 1998:

The Clinton Proposal was followed by the Internet Tax Freedom Act of 1998 (14). Concerned with the negative effect of taxation by local governments on the growth in online sales; the US Congress, with Clinton Administration backing and the support of John McCain in the Senate, attempted (with minor exceptions) to make the Internet a tax free zone. This legislation established a three-year moratorium on the state and local taxation of Internet access and "multiple or discriminatory taxes on electronic commerce". The Act's major e-commerce provisions included:

- A ban until October 1, 2001, on any new taxes on Internet commerce or access charges.
- Grand-fathering of existing taxes.
- And, the creation of an Advisory Commission on Electronic Commerce (ACEC), which found in their Report to Congress "governments should keep the tax and administrative burden on consumers and businesses as low as possible", and outlined "It should not be presumed that the collection of sales and use taxes on internet transactions is an inevitability" (1).

The ITFA's statutory language suggested several specific topics for the Commission to study, including an examination of:

- The collection and administration of consumption taxes on electronic commerce in other countries and the United States, and the impact of such collection on the global economy, including an examination of the relationship between the collection and administration of such taxes when the transaction uses the Internet and when it does not.
- The impact of the Internet and Internet access on the revenue base for telecommunications excise taxes.
- Model state legislation that would provide uniform definitions of transactions subject to or exempt from sales and use taxes and would ensure that Internet access, online services, and transactions using the Internet, Internet access or online service would be treated in a tax and technology neutral manner relative to other forms of remote sales.
- The effects of taxation, including the absence of taxation, on all interstate sales transactions, on retail businesses and on state and local governments to collect sales and use taxes owed on interstate purchases from out-of-state sellers.

A proposal submitted to The Commission by state and local governments (8), sought a uniform sales tax regime that would have applied to e-commerce and other remote-sales transactions where the seller does not have a presence "or nexus" in the state where the buyer is – although not uniformly applied, the US Supreme Court has upheld the "nexus" test.

This moratorium on (amongst other things) new, multiple and discriminatory taxes on internet commerce expired October 21, 2001 at midnight after the U.S. Senate successfully rejected an effort to take up legislation passed by the House to extend the ban for two years.

3.3 The US Streamlined Sales Tax Project:

The U.S. Streamlined Sales Tax Project began in early 2000 as an initiative by state governments (via the Committee on State Taxation – COST (7)), with input from local governments and the private sector, to simplify and modernize sales and use tax administration for all types of commerce.

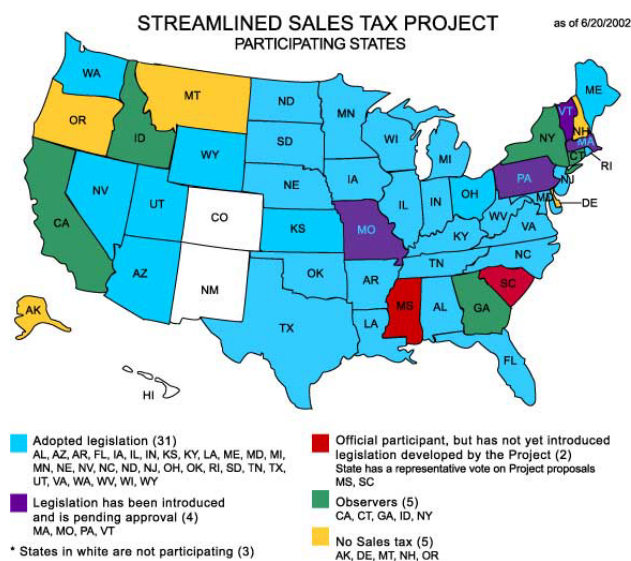


Figure 3: Streamlines sales tax project – participating states

This simplified system was to incorporate uniform definitions within tax bases, simplified audit and administrative procedures, and emerging technologies to substantially reduce the burdens of tax collection. The focus of the project is to improve sales and use tax collection and administration systems for both Main Street retailers, remote sellers, and for states. There are currently forty-two states involved in the project.

The project's main goal is to provide a sales and use tax systems that has the following characteristics:

- **Neutrality** – Taxability should be independent of the method of commerce used in a transaction.
- **Efficiency** – Administrative costs should be minimized for both business and government.
- **Certainty and Simplicity** – Tax rules should be clear and simple.
- **Effectiveness and Fairness** – Taxation systems should minimize the possibility of evasion.
- **Flexibility** – Taxation systems should keep pace with changes in the economy.

In January 2001, U.S. state leaders, working with more than 100 companies, unanimously adopted a model state streamlined sales and use tax legislation to remove

the burdens on business of compliance with thousands of different state and local sales tax systems. This new system proposes a 21st century, simplified tax system that would provide a single method of registration and a single means of reporting for all states, uniform rules and schedules for remittance to states, and uniform definitions of goods and services (15).

3.4 The European Union:

Although the US was undoubtedly the major player in e-commerce, American policy makers were not alone in their quest to define appropriate e-commerce taxation rules – Europe and other countries had equal concerns.

European Union members formally documented their own ‘plans’ for taxing Internet transactions, initially for example, in the Bonn Ministerial declaration and the European Commission’s 1997 “European Initiative in Electronic Commerce”. In the latter the principle of a “clear and neutral” tax environment was supported. However, the document clearly stated that “electronic trade in goods and services clearly falls within the scope of VAT” and pointed out that VAT would apply to the purchase of soft goods at the place of consumption.

In an extraordinary session on December 13, 2001, The EU Council of Economic and Finance Ministers met in Brussels and decided to move forward on two major tax initiatives - proposed directives on savings taxation and e-commerce VAT. On February 12, 2002 The Council reached a political agreement, on amending Regulation (EEC) 218/92 on administrative co-operation in the field of VAT and on amending the sixth Council Directive 77/388/EEC on VAT arrangements for certain services supplied by electronic means, as well as subscription-based and pay-per-view radio and television broadcasting. But these could only be formally adopted when all the language versions became available. This was done on May 7, 2002, when Council Directive 2002/38/EC was adopted. At the same time the Council adopted Council Regulation (EC) 792/2002, temporarily amending Regulation 218/92 on administrative co-operation in the field of indirect taxation, to introduce additional measures necessary for the registering of foreign e-commerce traders for VAT purposes and for distributing the VAT receipts to the Member States where the services were actually used (9) (10).

The new rules aim to ensure that certain electronically delivered services are taxed at the place of consumption. They can be summarized as follows:

- Non-EU suppliers will have to charge VAT on services electronically supplied to EU customers at the VAT rate of the Member State where their customer usually resides. They can register in the Member State of their choice (so called Member State of identification) and pay all VAT due on a quarterly base. The State concerned will then re-allocate the VAT revenues to the Member States where the consumer is located. Registration will not be necessary for non-EU established traders whose

annual level of sales within the EU is below EUR 100 000.

- When these services are provided by an EU operator to a non-EU customer, the place of taxation will be where the customer is located and they will not be subject to EU VAT.
- When an EU operator provides these services to a taxable person (i.e., to another business) in another Member State, the place of supply will be the place where the customer is established.
- Where the same operator provides these services to a private individual in the EU, or to a taxable person in the same Member State, the place of supply will be where the supplier is located.

Additional measures can be summarized as follows:

- Tax on supplies to business customers will be accounted for by the customer. Registration for tax purposes will only therefore be necessary if supplies are made to private customers.
- A single place of registration (which will, in practice, normally be the Member State to where a first taxable supply is made) will be possible. This will enable the operator to discharge all obligations for EU VAT with a single administration. This latter measure effectively puts EU and non-EU operators on an equal basis when supplying to EU customers.
- It will also be possible to complete electronically all procedures in relation to registration and the making of tax returns.
- Tax administrations will provide operators with the means to distinguish easily the status of the customers (i.e. whether the customer is a VAT registered business or not) and this will normally provide the means whereby a supplier, acting with all possible diligence, can determine whether or not a transaction should be charged with tax.

Existing VAT rules for other transactions remained unchanged.

3.5 The OECD:

The OECD at its Turku meeting in 1997 presented its own “framework conditions” (document 25 from the Committee of Fiscal Affairs) for dealing with taxation and e-commerce. It outlined the general tax principles that should be applied to e-commerce. Specifically: neutrality; efficiency; certainty and simplicity; effectiveness and fairness; and flexibility.

Of primary concern to OECD member states was their belief that the Internet would facilitate increased cross-border commerce and increase the mobility of business and capital. Related tax administration and compliance issues were also of concern. Specifically:

- They feared the lack of any user control as to the location of the activity (vendors don’t know where their customers are, customers don’t know where their vendors are, and governments don’t know where either participant is).
- They feared being unable to identify users.

- They feared the reduced use of information reporting and withholding institutions (disintermediation).
- And, they had concerns regarding the development of electronic payment systems.

Members also believed, and were equally concerned, that tax havens and offshore banking facilities would become more accessible and, presumably, more widely used to avoid or evade tax.

Based on a consensus reached on the Taxation Framework Conditions at their Ottawa conference (October 1998), which included participation of a number of non-OECD countries, the OECD committee on fiscal Affairs (CFA) set up Technical Advisory Groups (TAGS), to produce recommendations on a variety of issues. It also issued a draft-revised commentary to article 12 of the model treaty addressing the tax treatment of software. In addition, they proposed a change to the commentary on Article 5 of its model tax convention with respect to the definition of "permanent establishment." Under this expanded definition, the presence of a server or Web page by itself generally would not satisfy the requirements for a permanent establishment. A server could be a permanent establishment if it performed significant activities that were more than "preparatory" or "auxiliary." It was left up to each member country to adopt clear and certain rules as to what would constitute significant activities for that purpose.

But their work continues! Since the agreement on the taxation Framework Conditions, the organization, through its Committee on Fiscal Affairs ("Committee"), has pursued an ambitious work program directed at effective implementation of the framework conditions. A key element of that work program has been an international dialogue, involving not only OECD member countries but also the international business community and a number of non-member economies. In March 2001, they published a progress report on the implementation of the Framework Conditions and a number of other "key documents" have emerged from that work program - on international direct tax issues, on consumption tax issues, and on tax administration issues.

On international direct tax issues:

- The full text of the agreed "Clarification on the Application of the Permanent Establishment Definition in E-Commerce: Changes to the Commentary on the Model Tax Convention on Article 5"
- The final report on "Treaty Characterization Issues Arising from E-Commerce, which was produced by the TAG (Technical Advisory Group) on Treaty Characterization of E-Commerce Payments".
- A Discussion Draft on "Attribution of Profit to a Permanent Establishment Involved in Electronic Commerce Transactions, prepared by the Business Profit TAG".
- A discussion draft on "The Impact of the Communications Revolution on the Application of "Place of Effective Management" as a Tie Breaker Rule", prepared by the Business Profits TAG.

- A report by the Business Profits TAG summarizing progress made in the context of its mandate, and proposed areas of future work.

On consumption tax issues:

- A report by the Committee's Working Party No. 9 on Consumption Taxes: "Consumption Tax Aspects of Electronic Commerce".
- A report by the Consumption Tax TAG summarizing progress made in the context of its two-year mandate, and proposed areas of future work.
- A report by the Technology TAG summarizing, in particular, its advice on possible collection mechanism options for consumption taxes, and proposed areas of future work.

On tax administration issues

- A report by the Committee's Forum on Strategic Management: "Tax Administration Aspects of Electronic Commerce: Responding to the Challenges and Opportunities".
- A report by the Professional Data Assessment TAG summarizing progress made in the context of its two-year mandate, and proposed areas of future work.

It is evident the OECD sees the development of appropriate Internet taxation policies as a major international issue (18).

3.6 The World Trade Organization:

In terms of The World Trade Organization (WTO); currently tariffs are not imposed on most electronic transactions but are normally only applied to the physical trade of goods. However, The General Agreement on Trade in Services (GATS) (22), the WTO agreement covering trade in services, does include under "Communications Services", some sub-sectors which relate to conduction of electronic commerce (including data transmission services, electronic mail, information and database retrieval, electronic data interchange, and online information and data processing – including transaction processing).

In their "Declaration on Global Electronic Commerce" adopted at the Second Session of the (Geneva) Ministerial Conference on May 20, 1998, the WTO Members agreed to establish a work programme to examine all trade-related issues relating to global electronic commerce (specifically taking into account the needs of developing countries) but, to continue their practice of not imposing customs duties on electronic transmissions. Implementation of the Work Programme was assigned to four WTO bodies, namely; the Council for Trade in Services; the Council for Trade in Goods; the Council for TRIPS; and the CTD. The General Council adopted the plan for this work programme on September 25, 1998, initiating discussions on issues of electronic commerce and trade by the Goods, Services and TRIPS (intellectual property) Councils and the Trade and Development Committee (23) (24).

The Doha Declaration resulting from the November 2001, Fourth Ministerial Conference in Doha, Qatar; endorsed the work already done by the work

program on electronic commerce sub groups and stated that the WTO members would continue their practice of not imposing customs duties on electronic transmission. The Declaration stated that members would continue this practice until the Fifth Ministerial Conference (25).

But, the organization remains divided on the question of whether to treat electronic commerce transactions and digitally delivered products as goods or services. The issue is crucial for businesses engaging in e-commerce, since it determines which multilateral trade rules and market access obligations apply to these transactions. The United States, in particular, has urged that goods delivered in digital form be classified as goods rather than services to the maximum extent possible, thus automatically making such transactions subject to the mandatory basic market access provisions of the General Agreement on Tariffs and Trade ("GATT"). In contrast, the European Union has advocated a services classification, which would only require WTO members to commit to a market access liberalization over which they have significant discretion.

3.7 The Industry Perspective:

While governments strive to develop appropriate methods for taxing e-commerce (likely based on the residence of the consumer), consumers and technology vendors largely take an opposite view – no new Internet taxes.

The Internet Tax Fairness Coalition (a U.S. organization whose members include; AeA (formerly the American Electronics Association, America Online, Inc., Apple Computer, Inc., Cisco Systems, Inc., Direct Marketing Association, First Data Corporation, Information Technology Industry Council, Information Technology Association of America, Microsoft Corporation, Novell, Inc., Oracle Corporation, Software Finance and Tax Executives Council, Software & Information Industry Association, Sun Microsystems) contends that imposing additional taxes on Internet sales could severely hamper existing small and midsize resellers and retailers, and could prevent others from entering the market. They feel that interstate commerce and the economy are burdened by multiple, confusing and inconsistent state tax rules. Therefore, development of a simple and uniform system is critical. They support the following objectives for reducing the tax burdens imposed on interstate commerce that thwart the development of a borderless marketplace:

- Establish simple and uniform sales and use tax rules that reduce compliance burdens for all taxpayers.
- Enact nexus standards for business activity taxes that eliminate uncertainty and the potential for double taxation.
- Promote availability of the Internet to all by prohibiting taxes on access fees.
- Prevent multiple and discriminatory taxation by extending the application of traditional tax rules to electronic commerce.

In their letter to the of September 6, 2001 to The Finance Committee, following testimony at the August 1, 2001 Finance Committee hearing on "Cybershopping and Sales Tax: Finding the Right Mix"; they urged the Committee to move forward on the single point of consensus that emerged from the witnesses' collective testimony—that the moratorium of the Internet Tax Freedom Act ought to be extended. They made an identical plea to the US Congress suggesting, "If the ITFA moratorium is permitted to expire it will cast a chill over interstate commerce by signaling to the more than 7600 state and local taxing jurisdictions that disparate tax treatment of transactions based on the medium used is acceptable. The Internet Tax Fairness Coalition (ITFC) believes that Congress must not delay. We urge you to extend the moratorium on the imposition of these new taxes before it is too late". Their proposed draft legislation provided to extend the moratorium enacted by the Internet Tax Freedom Act through 2007, and encouraged States to develop an Internet tax regime that is simple and uniform (17).

"We're opposed to any new taxes on the Internet," says George S. Isaacson, acting director of the Association for Interactive Media (reportedly the largest Internet trade association) (12). Isaacson explains "We're working for the Amazons of the future to make sure they have the ability to grow and gain market share". In his presentation to the commission, he argued, "Information technology and electronic commerce have been the most important factors fuelling the largest and longest economic boom of this century" and warned against the negative effects of inappropriate e-commerce taxation policies (4).

However, there are more moderate and even dissenting views. Mark Negergall, president of the Software Finance and Tax Executives Council, says his group, compiled of major software providers, is neutral on taxation as long as the tax is non-discriminatory. "Our view is that we should be treated no better or worse than any other medium, such as telephone, telegraph, telefax or direct mail."

In spite of a study released by Ernst & Young (funded by the e-commerce Coalition) which challenges the notion that Internet commerce threatens to drain the treasuries of state and local governments; leadership in Silicon Valley appears to be siding with state and local governments in favor of taxing the Internet. As with other advocates for taxation, they argued that state and local governments need the potential sales tax revenues offered by on-line commerce. They suggest that failing to apply sales taxes to on-line transactions is fundamentally unfair and is a disadvantage to traditional in-store buying.

4. What Happens Next?

It is clear that if electronic commerce continues to grow (especially if the growth is at the expense of conventional commerce) the question of e-commerce taxation will have to be answered both at the domestic

and international levels. The current lack of neutrality and basic fairness in e-commerce taxation legislation will become more painfully obvious (at the heart of the debate is the principle that states and other local governments have the right to tax goods sold within their jurisdiction). Consequently any future discussion on e-commerce taxation must include the following key issues:

- The proper relationship between federal and the local governments on issues of taxation, and which levels of government ought to bear the responsibility for determining and financing the needs of their citizens and businesses;
- The necessity of keeping tax policy neutral so that neither traditional retailers nor remote sellers (catalog, Internet, or similar enterprises) are given an advantage based on tax policy;
- The need to stop erosion of essential revenue streams that support education and other key public services at the local level.

And, The technical issues on the table continue to be:

- What constitutes taxable presence from the use of the Internet?
- What is the tax classification of income from electronic activities (the main consequences being the application of withholding tax and indirect taxes)?
- How are taxpayers identified and their transactions audited?
- What are the implications for transfer pricing and the use of tax havens?

The U.S. is making an effort with its Streamlined Sales Tax System for the 21st Century Project. The European Union, growing more and more concerned about the potential loss of revenue adopted new rules with regards to VAT on electronic commerce which will come into effect in July 2003. But the new directive has drawn international criticism – the OECD, Japan and the U.S. have all voiced concerns. The Commission justified making its proposals without waiting for the outcome of the OECD negotiations, saying that under the Ottawa Framework, consumption taxes such as VAT should be levied in the jurisdiction where consumption takes place, and that for those purposes, a supply of digital products should not be treated as a supply of goods. It said the new proposals would ensure that the EU VAT system conformed to the framework's principles. Commissioners also assured the U.S. and Japan that they recognized the need for international collaboration on the taxation of e-commerce, but suggested that they were particularly concerned with simplifying European VAT rules to ensure that non-EU operations were brought within their scope as soon as possible. The is growing concern however that this unilateral move by the EU could open the floodgates for other nations to impose e-commerce taxes in an uncoordinated, cost-inflicting patchwork.

The OECD continues its work and is supported by the US in their efforts to create consensus around baseline taxation rules that could undergird the international

expansion of e-commerce. The WTO will present the latest developments in its efforts to address e-commerce taxation at the Fifth Ministerial Conference.

While the debate is far from with international “saber-rattling” continuing; the EU has definitely moved the discussion up a notch with its new electronic commerce directive. Only time will tell if their new “consumption-based” directive, and its inherent administrative cost burden, is taking the e-commerce taxation issue in the right direction. If accepted by the global community this shift in emphasis in allocating taxing authority, from the supply based residency concept to the consumption based residency concept, would provide an unprecedented opportunity for developing countries to increase their tax base – particularly for those developing countries, such as China, which are experiencing astronomical growth in internet usage.

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